Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
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A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems	)	**MB Docket No. 04-207**

COMMENTS OF THE HALLMARK CHANNEL

Crown Media United States LLC ("Crown Media"), which operates the Hallmark Channel and Hallmark Movie Channel, submits these comments in response to the Commission's Public Notice, DA 04-1454, released May 25, 2004, seeking information regarding the a la carte and "themed-tier" distribution of programming services on cable television and direct broadcast satellite ("DBS") systems. Government-mandated a la carte or "themed tier" carriage would change the fundamental economics of the marketplace for non-premium programming services. The likely result of such regulation would be higher prices to consumers, lower quality programming, and a reduction in the diversity of programming available to viewers. Such regulation also is likely to lead to a reduction in "independent" first amendment speakers or content owners and providers.

Crown Media distributes the Hallmark Channel and Hallmark Movie Channel to cable and DBS systems and to any and all other multi-channel video programming distributors ("MVPDs"). The Hallmark Channel is an advertiser and license fee supported programming service that provides award-winning, family-oriented programming, including original movies and series, mini-series and first-run presentations from Hallmark Entertainment and third parties, as well as syndicated programs. For example, Hallmark Channel this year will air 15-18 original movies and mini-series, such as "King Solomon's Mines" and "The Long Shot," starring Marcia Mason. In addition, we air "acquired" movies, such as the original and remake of the "Parent Trap," and series, such as "Mash," "Touched by an Angel," "Doctor Quinn Medicine Woman," "The Waltons," classic westerns and comedies, and, later this fall, "JAG." In addition, we produce and air award-winning series such as "Adoption," which tells compelling stories about the adoptive experience and received the National Angel Award from the Congressional Coalition on Adoption Institute. Hallmark Channel and Hallmark Movie Channel are the exclusive "home" for movies from the "Hallmark Hall of Fame Collection" after their initial airing on broadcast television. The Hallmark Channel is now distributed to roughly 62 million homes in the United States, primarily through analog cable and highly-penetrated DBS distribution.

The Hallmark Movie Channel, launched earlier this year, features top-rated movies and mini-series, many of which are produced by Hallmark Entertainment, the world's largest producer of made-for-television movies and mini-series. Hallmark Entertainment movies comprised 12 of the 25 highest-rated movies aired this season by ABC, CBS and NBC.

A. The Rise of the Hallmark Channel Exemplifies the Expanded Programming Choices Available to Viewers and the Growing Popularity of Advertiser-Supported Non-Broadcast Programming Services.

Cable television and DBS subscribers currently enjoy a wider selection of programming services than ever before. Digital cable upgrades and expanded satellite capacity have enabled the distribution of a wider variety of programming services and the introduction of new services like HDTV, video on demand and digital video recorders. More and more programmers are developing and promoting original movies and series. As the Commission concluded, due in part to "technological advances and investment in new platforms for delivering video programming, the vast majority of Americans enjoy more choice, more programming and more services than any time in history." See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming (Tenth Annual Report), 19 FCC Rcd. 1606, (2004) ("Tenth Video Competition Report") at ¶4.

Not only are there "a growing number of cable networks," but "their popularity is increasing" steadily. Tenth Video Competition Report at ¶26. The Commission recently reported that there are 339 national, satellite-delivered, non-broadcast programming networks (compared to only 106 in 1994) and approximately 84 regional programming networks. Id. at ¶¶17, 142, 146. Programmers continue to develop and implement new programming concepts, with over 61 new services planned and in various stages of development. Id. at ¶146.

The popularity of these services is reflected in their increasing viewership share. The combined audience share of non-broadcast cable television networks has climbed steadily from a 29 share in 1993 to a 55 share in 2003. Id. at ¶26. The increasing share of cable viewership reflects not only the sheer number of programming options offered by cable and satellite distributors, but also the fundamentally improved quality and increasing popularity of the available programming.

The Hallmark Channel's own story of subscriber and ratings growth illustrates this phenomenon. The Odyssey Channel, its predecessor, had achieved only limited distribution to 26 million homes by 2000, almost half of which received the Odyssey Channel part-time. Consequently, it could make only limited investments in programming and marketing. Because its programming was largely unrated by Nielsen, advertising revenues were stagnant.

In 2001, Crown Media launched the Hallmark Channel and redoubled its efforts to expand distribution and to increase consumer awareness of the channel and its programming.

For example, Crown Media renegotiated its agreement with DIRECTV to retier Hallmark Channel from DIRECTV's "Family" package to its highly-penetrated "Total Choice" package, which immediately increased its DIRECTV distribution more than ten-fold. We made this effort and substantial investment because, notwithstanding the expected appeal of a smaller tier directed at families, viewership of Hallmark Channel was low and distribution of the "Family" package remained limited. Likewise, Crown Media was able to negotiate subscriber commitments with a number of major cable operators that yielded many millions of additional subscribers.

This rapid subscriber growth has yielded increased subscriber and advertising revenues which have enabled Hallmark Channel to develop more and better original programming and to pursue more attractive syndicated programming. The Hallmark Channel has invested over $500 million in programming production and acquisition. The result has been a dramatic improvement in its viewership and ratings. For the first half of 2004, Hallmark Channel has ranked among the top ten cable networks in total day household rating -- a remarkable achievement when its distribution and tenure are compared with those of the other more widely distributed and established networks in the Top 10. It reached an all-time high and delivered double-digit ratings growth when compared to 2002-03 in household ratings for both total day and prime time. These ratings data are consistent with and supported by recent surveys of viewers which yielded similarly compelling results. Two-thirds of its viewers feel there is something unique about Hallmark Channel, and 93% of viewers rated it positively ("excellent/very good/good"). Surveyed viewers associate Hallmark Channel with programming that is "entertaining," "traditional," "contains a positive story," "high quality," and which parents "can trust for all ages." More than 8 out of 10 viewers of Hallmark Channel are likely to recommend it to others to watch. Consequently, Hallmark Channel consistently is among the channels most requested by viewers in systems where it is not currently carried.

B. Advertiser-Supported Networks Such As the Hallmark Channel Depend Upon Broad and Highly-Penetrated Distribution.

In the midst of this burgeoning popularity and viewership endorsement, the obvious question is why does Crown Media not embrace a la carte distribution so that it can achieve higher subscriber revenues. Crown Media respectfully submits that the answer is in the economics and the business model upon which it has built the Hallmark Channel.

The Hallmark Channel and the vast majority of the non-broadcast cable programming services rely principally on two sources of revenue: (a) license fees paid by the cable operator on a "per subscriber, per month" basis; and (b) advertising sold on the programming network. For these programmers, broad distribution through carriage in the most popular packages of programming services is essential to maximize revenues and control costs. Consequently, as the United States General Accounting Office ("GAO") has reported, "most [advertiser supported] cable networks require that cable operators place their networks on widely distributed tiers." United States General Accounting Office, "Telecommunications: Issues Related to Competition and Subscriber Rates in the Cable Television Industry," Report No. GAO-04-8 (rel. Oct. 24, 2003) ("GAO Report") at 6.

Since it launched Hallmark Channel, Crown Media has pursued this same approach. Consequently, Crown Media's affiliation agreements typically require MVPDs to distribute Hallmark Channel on basic or expanded basic or a specific tier such as "Total Choice," to achieve a distributor-wide level of penetration; to provide a specified number of service subscribers; and/or to satisfy some other distribution requirement. Crown Media believes that such distribution commitments are crucial to not only its current business but also its future plans.

Although the Commission has suggested that programming services may survive with a subscriber base of 15 to 20 million subscribers,[1] that is inconsistent with Crown Media's experience in today's marketplace. With nearly 26 million full- and part-time subscribers, the performance of the Hallmark Channel's predecessor was stagnant and its financial prospects were dim. Although Nielsen may rate a programming service with 20 million subscribers, few advertisers will buy advertising and the cost per thousand rates generally are not competitive. Advertisers are interested in such networks only if they are emerging, i.e. their distribution is steadily and rapidly increasing.

The Hallmark Channel's experience suggests that the more realistic plateau for meaningful advertising revenues is now approaching 50 to 60 million subscribers. Subscribers to Hallmark Channel more than doubled from 2000 to 2003 with distribution topping 56 million in 2003. As a result of that growth, coupled with improved ratings, advertising revenues increased by more than four times, with the largest percentage increase in advertising revenues occurring when distribution approached 56 million and more subscribers. Crown Media is projecting that an approximate increase in subscribers of 20% from 2003 to 2004, coupled with a further improvement in ratings, will yield more than a 70% increase in advertising revenues. Thus, these data support the conclusion that substantially greater advertising revenues are available to programming services with 50 to 60 million subscribers -- a level of subscribership associated with a viable broad-based entertainment programming network in today's competitive marketplace.

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[1] See, e.g., Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, 14 FCC Rcd. 19098 (1999) at ¶¶40-41; Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, 13 FCC Rcd. 24284 (1998) at ¶152.

Even with these levels of national distribution, programming networks which have not achieved full distribution still encounter challenges in local markets. For example, such networks often have difficulty in obtaining program listings and articles in newspapers and specialty publications in markets in which they are not fully distributed. Likewise, television critic reviews of new shows and similar "free" publicity often are unavailable. Unless a programmer has achieved widespread distribution in a market, advertising to develop viewership and brand recognition usually is cost-prohibitive.

C. A La Carte Distribution Would Have Stifled the Hallmark Channel's Growth and Would Reverse its Successes.

The launch of Hallmark Channel was based upon a business plan of widespread distribution by cable and DBS operators on highly-penetrated packages of popular programming services. Shifting advertiser-supported programming services from such tiers or dismantling them to create "mini-tiers" or a la carte carriage would have nullified Crown Media's business plan. The opportunity to achieve rapidly-increased distribution would not have existed. Instead, Crown Media would have had to convince each cable system to launch the Hallmark Channel and then convince individual households to subscribe to it. This kind of broad retail campaign would have been cost-prohibitive, and Crown Media believes that it would have been virtually impossible to obtain the minimum number of subscribers needed for a viable advertiser-supported service.

For independent channels such as Hallmark Channel, a la carte distribution would be cost-prohibitive. It does not have a broadcast network to use as a cross-promotion vehicle. For example, it cannot exploit the kinds of cross-promotional opportunities available to such NBC programming networks as Bravo, Sci-Fi, and USA. Likewise, the Disney, Fox, Turner, and Viacom stables of networks can take advantage of cross-promotional opportunities which are simply unavailable to independent networks such as Hallmark Channel. Moreover, because Hallmark Channel did not launch until 2001, it has not had the opportunity to build brand awareness or brand "equity" over 15 to 25 years as have many of the fully-distributed networks of the media conglomerates. A la carte distribution likely would lead to increased consolidation because only the multi-channel media giants would have the financial wherewithal and promotional outlets to pursue the kind of marketing required to convince individual subscribers to make the purchase decisions for their channels.

Crown Media cannot provide an empirical estimate of the likely decrease in the distribution of its channel in an a la carte or mini-tier world because there is no precedent for it. However, Crown Media believes that it would lose a very substantial number of subscribers[2] -- if for no other reason than the difficulty of effectively marketing Hallmark Channel to individual viewers. Crown Media's affiliate relations and marketing staffs have a limited budget and are directed at marketing Hallmark Channel to distributors and developing the brand. The extent of such subscriber losses also would depend upon the retail pricing decisions of other programming services, their marketing resources and efforts, and the marketing decisions of cable and DBS operators, which also would have little or no experience with the marketing of dozens of advertiser-supported programming services.

Although Crown Media has no direct experience from which to estimate subscriber losses that would result from a la carte carriage, the available marketplace experiences indicate that the loss likely would exceed 50%. According to Bear Stearns, HBO -- which has been marketing a la carte services for decades and has the best known brand name in the

[2] Clearly, its subscribership and advertising revenues would decrease significantly. According to the GAO Report, programmers have concluded that "any movement of networks from the most widely distributed tiers to an a la carte format could result in a reduced amount that advertisers are willing to pay for advertising time because there would be a reduction in the number of viewers available to watch the networks." GAO Report at 35.

business -- achieves only "approximately 30% penetration of basic cable subscriptions." See, Raymond Lee Katz, et al., Bear Stearns, "A La Smart?," (March 29, 2004) at 4. Regional sports networks, before they converted from a la carte to basic carriage, routinely achieved less than 10% penetration. Id. Likewise, the nationally-distributed and marketed Golf Channel was launched originally as an a la carte channel, but it could not achieve a sustainable level of distribution and subsequently was relaunched as an advertiser and license-fee supported network.

As explained above, a 20% increase in Hallmark Channel's subscribership and improved ratings is likely to yield more than a 70% increase in advertising revenues. Thus, although we believe that subscriber losses would be very substantial in an a la carte world, even a modest decrease in subscribers would cause a much larger percentage decrease in advertising revenues. Consider the following example of this potential impact. Typically, annual advertising revenues range from $1.00 to $6.00 per subscriber for programming services, depending upon programming genre, target audience, and brand identity. If a programming service with 70 million subscribers and $3.00 per subscriber in advertising revenues lost only 20% of its subscriber base due to a la carte, it would lose $42 million in advertising revenues in the first year alone. A greater initial subscriber loss or subsequent erosion of subscribers would only make the revenue picture bleaker. Of course, these lost advertising revenues are only part of the picture; there also would be lost subscriber revenues unless license fees were increased.

Further, in addition to these kinds of numerical projections, a la carte distribution will introduce another layer of uncertainty which is likely to affect adversely the advertising market and revenues. For example, advertiser-supported services such as Hallmark Channel have no experience with the level of churn to be expected in an a la carte world. Consequently, in addition to the uncertainty and variability inherent in ratings, programmers will have month-to-month variations in subscribership -- in contrast to their broadcast network competitors which will have government-mandated universal distribution. Thus, as one example, the level of predictability necessary for the "up front" advertising market will be difficult if not impossible to achieve.

D. Government Mandated A La Carte Distribution or Mini-Tiers Will Increase Costs to Consumers and Decrease Diversity.

There is no doubt that moving programming from, or dismantling, highly penetrated programming package such as the traditional expanded basic tier would adversely affect subscriber and advertising revenues. Crown Media believes that many programming services, whose business plans were built upon the current statutory and regulatory scheme, would cease to exist. Certainly, the scores of planned programming services would be foreclosed from ever entering the market. If a programmer could reinvent itself in this environment and survive, it would have to compensate for the lost subscriber and advertising revenues in two ways -- by increasing subscriber fees and reducing costs. However, that same programmer would have to increase its marketing budget exponentially because it is now selling to the more than 90 million households subscribing to cable and DBS television rather than to its distributors. Consequently, this substantial increase in marketing cost would make it that much more difficult to reduce costs, and any such reductions necessarily would involve programming expenditures.

For a programming service such as Hallmark Channel, which has a modest monthly license fee and relies heavily on advertising revenues, this increase in license fee would be substantial -- some multiple of its existing fee.[3] As the GAO has reported, cable operators in

[3] In addition to increasing programming costs for the subscriber, a la carte carriage would require additional equipment expenditures by cable subscribers. In order to implement a la carte carriage of programming now available on broader tiers, each network would have to be scrambled by the cable operator and descrambled by an

turn would pass some or all of the license fee increase through to the subscriber. See GAO Report at 6 ("If license fees rise, some of the increase is likely to be passed on to subscribers."). There can be no doubt that the price of the Hallmark Channel to viewers would increase by several orders of magnitude.

Programming diversity would be adversely affected in at least four ways. First, as noted above, it is highly unlikely that new program networks would be launched. The economies of scale that Crown Media has achieved have enabled it to bring its second linear channel, Hallmark Movie Channel, to the marketplace. Second, existing programmers would be forced to cut programming costs. Again, Crown Media's experience with Hallmark Channel is instructive. As its subscriber and advertising revenues for Hallmark Channel have increased, Crown Media has substantially increased its programming budget and pursued original programming initiatives. If its subscriber and advertising revenues were reduced, it would have to reduce its programming expense substantially. Third, some (probably many) networks simply would not survive a move to a la carte carriage, particularly new programming networks and those targeted toward niche markets. As noted in the GAO Report, "[a] variety of factors -- such as the pricing of a la carte service, consumers' purchasing patterns, and whether certain niche networks would cease to exist with a la carte service -- make it difficult to ascertain how many consumers would be better off and how many would be made worse off under an a la carte approach." GAO Report at 6. Fourth, a la carte or themed tiers would lead to a reduction of diverse "independent" content providers because the economic burdens would be so great that

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addressable converter at each television set connected to the cable system. Thus, even if a subscriber could obtain all of the programming services now carried in the basic and expanded basic tiers on an a la carte basis for exactly the same programming fees, the additional equipment charges could be more than $13 per month for a subscriber connecting three televisions to the cable system. See GAO Report at 32.

only the large media companies with substantial operating economies would be left to compete. And even they would not be guaranteed success.

Finally, subscribers would lose still other advances and improvements. We have also been able to bring to viewers some of our movies in the enormously compelling High Definition format and through Video on Demand and Pay per View offerings. A la carte and themed tiers will undercut the economics that have allowed us to branch out with these additional valuable services.

In short, cable subscribers would pay more and receive less. Because "the economics of the cable network industry could be altered" significantly by an a la carte approach, "subscribers' monthly cable bills would not necessarily decline under an a la carte system" and "cable rates could actually increase for some consumers" under an a la carte regime. See GAO Report at 34, 36. However, they would receive fewer programming services, and those services would be offering less costly programming.

Conclusion

When it launched Hallmark Channel, Crown Media understood the regulatory environment and the additional challenges, such as must-carry and retransmission consent, that it faced. It built its business plan to meet those challenges, and its distribution and ratings have increased dramatically each year. Crown Media respectfully submits that mandated a la carte distribution or mini-tiers would undermine all that it has achieved. Such government action would interfere with Crown Media's existing distribution contract rights. Further, if broadcasters were still accorded must-carry or retransmission consent rights to the basic tier, Crown Media would be denied equal protection and its first amendment rights abridged. The ability of broadcasters to cross-promote their other cable channels through their government-mandated preferred distribution would only increase the injury to Crown Media and similarly-situated independent programmers.

There is a fundamental difference between selection and choice. While a la carte carriage may increase a consumer's control over the selection of programming in the short term, the long-term cost of mandatory mini-tiers and a la carte distribution is likely to be reflected not only in increased subscriber bills, but also in reduced programming choices and quality. Likewise, any regulatory program to promote "voluntary" a la carte service offerings to control cable rates would likely be accompanied by government involvement in pricing which adversely affected programmers and diversity in the past. Crown Media respectfully submits that, notwithstanding the distortions to the marketplace already introduced by government initiatives such as must-carry and retransmission consent, competition is working well and the viewers have been the beneficiaries.

Respectfully submitted,

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